Before the
Federal Communications Commission
Washington, DC 20554

In the Matter of Application by Verizon Virginia Inc., Verizon Long Distance Virginia Inc., Verizon Enterprise Solutions Virginia Inc., Verizon Global Networks Inc., and Verizon Select Services of Virginia Inc., for Authorization To Provide In-Region, InterLATA Services in Virginia	)))))))))))	WC Docket No. 02-214

SUPPLEMENTAL COMMENTS OF AT&T CORP. ON VERIZON'S REVISED SWITCHING PRICES

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In the Matter of Application by Verizon Virginia Inc., Verizon Long Distance Virginia Inc., Verizon Enterprise Solutions Virginia Inc., Verizon Global Networks Inc., and Verizon Select Services of Virginia Inc., for Authorization To Provide In-Region, InterLATA Services in Virginia	)))))))))))	WC Docket No. 02-157

SUPPLEMENTAL COMMENTS OF AT&T CORP.
ON VERIZON'S REVISED SWITCHING PRICES

Pursuant to the Commission's public notice in this case on October 4, 2002, AT&T Corp. ("AT&T") respectfully submits these supplemental comments on the effect of Verizon's October 3 announcement that it is "voluntarily" reducing Verizon's prices for unbundled switching in Virginia. Verizon's 11th-hour rate reductions, however welcome, do not warrant approval of Verizon's Section 271 application. Even the reduced switching rates still exceed just and reasonable levels. The Commission cannot lawfully evade this issue merely because Verizon's *aggregate* non-loop rates benchmark with Verizon's aggregate non-loop rates in New York.

I. VERIZON'S REDUCED SWITCHING RATES STILL VIOLATE TELRIC.

AT&T demonstrated in its August 21 initial comments and September 12 reply comments that Verizon's prices for unbundled switching in Virginia were far above TELRIC-compliant levels. The evidence for this fact included (1) the fundamental

TELRIC errors that inflated Verizon's unbundled switching prices when the Virginia SCC set them in 1999—most notably, the SCC's arbitrary and unexplained assumption of a switch discount mix of 54 percent new/46 percent growth; (2) the substantial decline in the average cost of unbundled loops in Virginia as a result of growth in line counts since 1997, the vintage of most of the cost data underlying the SCC-prescribed rates; (3) the substantial declines in the discounted price of switching equipment and the enhancement of Verizon's buying power since 1996, when Verizon developed the switching cost studies underlying those rates; (4) the magnitude of the margins (36 and 45 percent, respectively) by which Verizon's non-loop rates and switching rates failed the Commission's standard benchmarking comparison against Verizon's New York rates; (5) the massive record in the pending arbitration proceedings involving Verizon's UNEs and UNE prices in Virginia, currently awaiting a decision on pricing issues by this Commission; and (6) Verizon's proposal, in the pending arbitration docket before the Commission, to *reduce* many of its existing rates—an implicit admission that those rates are unreasonably high.[1]

AT&T also demonstrated that the resulting cost overrecovery was massive: Verizon's recurring rates for switch utilization, if applied to projected utilization over the projected lives of Verizon's switching equipment in Virginia, would have allowed

[1] *See generally* AT&T initial comments at 5-11; *id*., Pitkin Decl. ¶¶ 27-29; Pitts Decl. ¶¶ 6-8; AT&T reply comments at 3-4; *id*., Baranowski Reply Decl.; and CC Docket No. 00-218, *Petition of WorldCom, Inc. Pursuant to Section 252(e)(5) of the Communications Act for Preemption of the Jurisdiction of the Virginia State Corporation Commission Regarding Interconnection Disputes with Verizon Virginia Inc., and for Expedited Arbitration*; CC Docket No. 00-251, *Petition of AT&T Communications of Virginia Inc. Pursuant to Section 252(e)(5) of the Communications Act for Preemption of the Jurisdiction of the Virginia Corporation Commission Regarding Interconnection Disputes With Verizon Virginia Inc*.

Verizon to recover more than *twice* the amount of its *embedded* investment in switching equipment.[2]

Verizon's 11th-hour reductions in those switching rates late last week, notwithstanding the company's predictable disclaimers that the rate reductions were "voluntary" and the previous rates were "TELRIC compliant" (Verizon Oct. 3 ex parte filing), is an obvious admission that the prior rates were unlawful. Verizon is not a company that gratuitously surrenders potential revenue from CLECs. The rate reductions do not cure the problem, however.

A. Verizon's Reduced Switching Rates Still Produce Significant Overrecovery Of Even Verizon's Embedded Costs.

As Michael R. Baranowski demonstrates in his attached supplemental declaration, even the reduced switches rates still produce a significant overrecovery of Verizon's costs. Even assuming *arguendo* is correct that investment for vertical feature hardware accounts for the inflated amount claimed by Verizon, the new switching rates proposed by Verizon will produce a 22.6 percent overrecovery of the forward-looking switching investment determined by the Virginia SCC. Baranowski Supp. Decl. ¶¶ 4-7.

Verizon's criticisms of Mr. Baranowski's switch overrecovery analysis are flawed. *Cf.* VZ Sept. 26 ex parte on costs. First, his assumption that Verizon's rates would continue without adjustment is consistent with the assumptions made in Verizon's own cost studies and the Virginia SCC's decision. Moreover, adopting a contrary assumption would require substituting a real (i.e., inflation adjusted) cost of capital for the nominal values advocated by the parties and adopted by the SCC. Baranowski Supp. Decl. ¶ 12.

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[2] AT&T reply comments, Baranowski Reply Decl. ¶¶ 3-5.

Equally unfounded is Verizon's claim that Mr. Baranowski erred in assuming that the level of switching minutes would remain constant over the life of the switch. This assumption is in fact *more* conservative than the switch usage assumptions in Verizon's own cost study. *Id*. ¶¶ 11, 15.

Third, there is no basis for Verizon's criticism of Mr. Baranowski's analysis for omitting costs related to engineering, furnishing and installation, power costs, and land and building investments. All of these items are included in Verizon's CAPCOST Plus annual cost factor program. *Id*. ¶¶ 13-14.

B. Verizon's Post Hoc Attempt To Justify The 54/46 Switch Discount Ratio Arbitrarily Assumed By the Virginia SCC Merely Confirms The Unreasonableness of Verizon's Rates.

Verizon's attempts to justify the 54 percent/46 percent mix of new and add-on discounts assumed by the Virginia SCC in setting Verizon's switching rates are also untenable. *See* 9/26 VZ ex parte on costs.

First, Verizon's analysis is sheer post-hoc rationalization. Verizon cites nothing in the SCC's own decisions or findings to suggest that the SCC undertook such an analysis in support of the 54/46 split. In fact, the record makes clear that the agency simply picked the 54/46 split out of a hat.

The SCC's "findings" in support of its decision to abandon the mix of new and growth equipment initially prescribed by the SCC consisted of the following two sentences:

> The Commission has evaluated the results of BA-VA's re-run cost studies and the comments submitted thereto, as well as the Staff Report and comments provided by parties. It is the Commission's determination that unbundled network element ("UNE") prices can be improved by revising the switching prices to reflect a switch equipment

mix of 54% new (replacement) and 46% add-on.[3]

The Staff Report relied on by the Commission, far from endorsing Verizon's proposed 54/46 split, attacked it as a "simplistic" approach that "ignores reality."[4] Verizon's attempt to "connect the switch equipment mix with the average life of switching equipment" was "erroneous."[5] In addition, the Staff Report noted, "BA-VA's analysis implicitly assumes that no excess capacity exists at initial purchase, because it assumes that each year's growth forecast would lead immediately to more equipment purchases."[6] Furthermore, the assumption of a planning period equal to the full depreciation life of the switching equipment was inconsistent with the five-year planning period assumed in Bell Atlantic's own cost studies.[7] Carried to its logical conclusion, this approach could be used to reduce the assumed proportion of new equipment purchases to zero "by using longer and longer observations periods," a result that the SCC "astutely" ignored in its initial decision because Verizon's approach would achieve neither "realism" nor "fairness."[8] Finally, the Staff Report took issue with the claim of the Virginia Cable Television Association ("VCTA") that the 54/46 split was the "effective result of one of the Staff's switch replacement studies": "*It should be noted that there is no such Staff study.*"[9]

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[3] Virginia SCC Case No. PUC9790005, Order entered Nov. 19, 1998, at 2.

[4] *Id*., Report of SCC Division of Communications, Division of Economics and Finance, and Office of General Counsel (Aug. 31, 1998) at 22-24.

[5] *Id*. at 22.

[6] *Id*. at 23.

[7] *Id*. at 24.

[8] *Id*.

[9] *Id*. (emphasis added).

The SCC's failure to provide any reasoned explanation for its abrupt change of position on the appropriate mix of replacement and growth equipment, exemplified by the agency's crude misreading of its own Staff Report, was a clear breach of the agency's duty to set just and reasonable UNE prices under the 1996 Act and the Commission's TELRIC standards. As Judge Posner explained in *Shurz Communications, Inc. v. FCC*, 982 F.2d 1043, 1050 (7th Cir. 1992), a decision is arbitrary and capricious when

> [k]ey concepts are left unexplained, key evidence is overlooked, . . . contradictions within and among Commission decisions are passed over in silence [and] [t]he possibility of resolving a conflict in favor of the party with the stronger case, as distinct from throwing up one's hand and splitting the difference, was overlooked.

Needless to say, the post hoc rationalizations set forth in Verizon's September 26 ex parte also cannot serve as a lawful basis for upholding the Virginia SCC's arbitrary change of course. A prerequisite for giving deference to the supposedly expert reasoning of an administrative body is that the reasoning must actually be stated so the path of the agency's reasoning may be discerned. Hence, the Commission cannot lawfully give deference to post hoc reasoning supplied after the fact by counsel for one of the litigants. *Burlington Truck Lines v. United States*, 371 U.S. 156, 168-69 (1962); *Citizens to Preserve Overton Park, Inc. v. Volpe*, 401 U.S. 402, 414-16 (1971); *K N Energy, Inc. v. FERC*, 968 F.2d 1295, 1303 (D.C. Cir. 1992).

In any event, Verizon's current analysis is as unsound as its predecessors. Apart from the deficiencies in Verizon's approach noted in the SCC's 1998 Staff Report, the Verizon calculations underlying the 54/46 split suffer from a crude computational error. Verizon uses the relative weighting of switch investment *dollars* produced by a conventional replacement/growth analysis—i.e., the *output* of the analysis—and uses it in its computations in lieu of the mix of replacement and growth *capacity*—the proper value. Baranowski Supp. Decl. ¶ 16. Correcting this error alone would produce a switch discount mix of approximately 80 percent new equipment and 20 percent add-on equipment, yielding approximately the reduced rates that Verizon announced on October 3, 2002. Baranowski Supp. Decl. ¶ 18.

Verizon's switch discount analysis contains a second and unrelated error, however: it assumes that demand for switching will grow by three percent over the entire economic life of the switches. In its September 26 ex parte filing, however, Verizon asserts that demand is as likely to shrink as grow in the foreseeable future.[10] These two assumptions are irreconcilably at odds. *Id*. ¶ 17.

Modifying the growth assumption downward to two percent annually over the switch life would yield a 86/14 replacement/growth weighting and produce a 38 percent reduction in switch usage and port rates. Modifying the growth assumption downward to one percent annually over the switch life would yield a 93/7 replacement/growth weighting, and produce a 46 percent reduction in switch usage and port rates. And assuming a zero percent growth rate – i.e., the growth rate most consistent with the position that Verizon takes on the AT&T over-recovery analysis – would yield a 100/0 replacement/growth mix, and produce a 55 percent reduction in switch usage and port rates. Each of these three alternative assumptions would yield rates substantially less than the reduced rates that Verizon has announced. *Id*., ¶ 19-21.

[10] Verizon Sept. 26 ex parte at 17.

C. Verizon's Remaining Defenses Of Its Switching Rates Are Also Without Merit.

Verizon's remaining defenses of its switching rates are largely variations on its strategy of evading the ultimate statutory issue—whether the switching prices are just and reasonable—by seizing up administrative rules of convenience that demonstrably do not work in the circumstances of this case.

Verizon thus claims, for example, that its switching rates must be upheld as TELRIC compliant today if they were TELRIC complaint when originally prescribed. The Commission, Verizon argues, has held that intervening changes in costs or the reopening of the pricing record by the state commission are irrelevant in a Section 271 case. *See*, *e.g.*, Verizon 9/26 ex parte on costs.

The only costs that are ultimately relevant, however, are the forward-looking costs of the unbundled elements today. Today's forward-looking costs, not the costs that existed in 1997 or earlier (the vintage of the data in the first generation UNE case in Virginia), are the costs that Verizon incurs when it self-provisions its network elements to itself as an incumbent retail supplier. If the Commission abdicates its duty to ensure that CLECs can obtain unbundled network elements from Verizon at prices based on those costs, the Commission has failed to comply with its own TELRIC standard and has created an unlawful barrier to competition.

A *de minimis* rule that ignores small cost changes—i.e., a presumption that the costs found by the state commission in the past are still a good proxy for current forward-looking costs if costs have not changed much during the intervening period—may be a reasonable rule of administrative convenience. AT&T has no objection to a common-sense policy. But the post-1997 cost changes at issue here are hardly trivial. An inflexible policy of refusing to consider evidence of post-record changes in costs, no matter how large, would be arbitrary, capricious, and a violation of the 1996 Act.[11]

Verizon's further claim that the Commission must uphold as TELRIC compliant the original switching rates filed with its application because they were within range of the *proxy* default values set by the Commission in 1996 would take the Commission even deeper into arbitrariness. *Cf*. 9/26 Verizon ex parte. The RBOCs—*including Verizon*—vociferously criticized the default values from the outset as crude and inaccurate, and the 8th Circuit subsequently held that the Commission was estopped from enforcing them after disavowing them in the first *Iowa Utilities Board* case before the Supreme Court. *Iowa Utilities Board v. FCC*, 219 F.3d 744, 756-57 (8th Cir. 2000).

The Commission must also decline Verizon's invitation to abdicate its responsibilities under Section 271 by relegating to a separate state proceeding under Section 252 the issue of whether Verizon's current switching prices are TELRIC compliant. The 1996 Act requires the Commission, before granting a Section 271 application, to determine whether the applicant's rates are just and reasonable—not merely that they were just and reasonable at some point years in the past. *See* 47 U.S.C. § 271(c)(2)(B)(ii) (incorporating *id.*, § 252(d)(1)). Absent current or recent TELRIC-compliant cost findings by a state commission (here, the Commission itself, standing in the shoes of the Virginia SCC in the pending arbitration case), the Commission must step

[11] The arbitrariness is heightened by the more rudimentary state of TELRIC costing precedent in 1997, a fact that Verizon itself notes. Verizon Sept. 26 ex parte letter at 3 ("the SCC was presented" in the 1997 rate case "with the task of setting TELRIC UNE rates less than a year after the passage of the Act, at a time when there was a vastly more limited body of case law, state decisions, and FCC explication of TELRIC principles").

up to the plate and resolve the issue for itself. If it does not or cannot verify that the rates are currently just and reasonable, it cannot lawfully approve the application.[12]

Finally, Verizon's defense of its true-up commitments as an excuse for granting its 271 application even without a finding that its current rates are just and reasonable is also untenable. Verizon makes no response to AT&T's central point: the barrier to competition created by unreasonable UNE prices is not eliminated by the mere possibility that an unknown number of Verizon's existing UNE prices may be adjusted by unknown amounts at some unknown time in the future. Particularly now, with most of the CLEC sector in bankruptcy or desperate financial straits, and outside funding for capital investments having dried up, no prudent manager will make the large sunk investments needed for such entry based on a business plan that assumes the implementation of a large number of future rate reductions whose magnitude, timing, and very existence are all speculative. AT&T comments a 10-11.

The prior Commission precedent on the significance of true-up commitments is clearly distinguishable: in *none* of the cases cited by Verizon did the Commission rely on a promised true-up as a basis for approving a 271 application where the rates to be trued-up involved an element that accounted for as large a share of total platform costs as switching. *See New York 271 Decision* ¶ 258 ("Uncertainty will be minimized if the interim rates are for a few isolated ancillary items").

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[12] Verizon's assertion that its count of ARMIS "switched access lines" in Virginia has been declining (VZ reply comments at 61) is meaningless. A meaningful comparison would need to include both the lines that Verizon supplies at retail, and the capacity that Verizon supplies as a supplier of UNEs or wholesale services. This Verizon has not done.

II. IGNORING VERIZON'S CONTINUING FAILURE TO ESTABLISH JUST AND REASONABLE SWITCHING PRICES MERELY BECAUSE VERIZON'S AGGREGATE NON-LOOP RATES BENCHMARK WITH NEW YORK RATES WOULD BE ARBITRARY AND CAPRICIOUS.

Verizon's main defense of its new switching rates is not a demonstration that the new rates satisfy the TELRIC standard, but a request that the Commission ignore the issue entirely because Verizon's new switching rates, when lumped together with all of Verizon's other non-loop rates, now satisfy an aggregate benchmark comparison with Verizon's New York rates. While Verizon's position finds some support in recent Commission rulings in other Section 271 cases, those rulings are inconsistent with the Act, and AT&T respectfully urges the Commission to not to follow them here.

The Commission may not lawfully approve Verizon's 271 application without specifically finding that Verizon's switching rates are just and reasonable. The Commission may not avoid this obligation merely because some larger combination of UNEs, of which switching is only a subset, have a lower rate-to-cost ratio than the corresponding bundle of UNEs in New York.

These propositions are rooted directly in Section 271. Section 271(d)(3)(A) entitles a Bell operating company like Verizon to begin providing in-region interLATA service only if the Commission finds (among other things) that the company has satisfied the competitive checklist set forth in Section 271(c)(2)(B). The second item in the checklist, Section 271(c)(2)(B)(ii), requires that the Bell company provide "[n]ondiscriminatory access to network elements in accordance with the requirements of sections 251(c)(3) and 252(d)(1)." And Section 252(d)(1) in turn requires that the charge for a network element be "just and reasonable" and "based on the cost . . . of providing . . . *the* network element." 47 U.S.C. § 252(d)(1) (emphasis added).

Moreover, recognizing the separate competitive potential of unbundled switching and unbundled transport, Congress specifically required that each be offered separately, unbundled from the other. Competitive checklist item five requires Bell companies to offer "[l]ocal transport from the trunk side of a wireline local exchange carrier switch *unbundled from switching or other services*." 47 U.S.C. § 271(c)(2)(B)(v) (emphasis added). And competitive checklist item six requires Bell companies to offer "[l]ocal switching *unbundled from transport, local loop transmission, or other services.*" *Id*., § 271(c)(2)(B)(vi) (emphasis added). The competitive potential of unbundling switching and transport will remain stillborn, however, unless each element can be ordered an appropriate separate price. Hence, "TELRIC prices are calculated on the basis of *individual* elements." *Verizon Communications Inc. v. FCC*, 122 S.Ct. 1646, 1678 (2002) (emphasis added).[13]

Unlike the just and reasonable pricing standard prescribed in Section 251, 252 and 271, the Commission's benchmarking policy appears nowhere in the 1996 Act. Rather, it is a Commission invention, adopted purely for administrative convenience. This administrative policy encompasses two shortcut presumptions. First, network elements in a particular state will satisfy the statutory cost standard if (a) the same carrier's prices for network elements have been found to satisfy the cost standard in another state, and (b) the rate-to-cost ratios of the carrier's prices in the state at issue do not exceed the corresponding ratios in the state where the Commission has already made a direct determination of the carrier's costs (with the relative costs in the two states based on Commission runs of the Synthesis Model in both state). *See, e.g., KS/OK 271 Order* ¶¶

[13] *See also AT&T Corp. v. Iowa Utilities Board*, 525 U.S. 366, 394 (1999) ("The dictionary definition of 'unbundled' (and the only definition given, we might add) matches the FCC's interpretation of the word: 'to give separate prices for equipment and supporting services.'").

82-89; *PA 271 Order* ¶¶ 62-66; *Rhode Island 271 Order* ¶¶ 37-58. Second, if the non-loop rates satisfy a benchmark comparison in the aggregate, each of the individual network elements within this group will be presumed to satisfy a benchmark comparison individually. *Rhode Island 271 Order* ¶ 40; *New Jersey 271 Order* ¶ 52.

There is nothing per se unlawful about these presumptions. Evidentiary shortcuts of this kind are common in administrative adjudication, and AT&T does not suggest that the Commission lacks authority to use such presumptions in appropriate circumstances. Where the record provides a plausible reason to believe that Commission-made presumptions are likely to produce misleading results in a particular case, however, rigid adherence to the presumptions when the results are at odds with the underlying statutory requirement is arbitrary and capricious. Those are the precise circumstances here.

The record in this case makes clear that mechanical application of the Commission's non-loop benchmarking approach in lieu of directly scrutinizing the reasonableness of Verizon's switching costs would be arbitrary and capricious. As explained by AT&T in the recent New Hampshire/Delaware 271 case, the Synthesis Cost Model—the model used by Verizon and other CLECs to adjust for relative cost differences between the anchor state (here, New York) and the comparison state (here, Virginia) tends to overstate transport costs, and overstate transport costs disproportionately as line density declines.

Exhibit 2 illustrates this point graphically. The exhibit compares the estimates of Verizon's transport costs generated by the Synthesis model for each state in the Verizon South territory (plus New York) with the UNE prices actually set by state commissions in each state (a rough surrogate for the TELRIC of transport in each state).[14] As the exhibit

[14] To assure comparability, in computing the per-line UNE prices, we assumed the same volumes as assumed in the Synthesis Model. Needless to say, AT&T does not contend that the transport

shows, the estimates of transport costs generated by the Synthesis Model, while roughly comparable to commission-prescribed transport prices in the higher density states, climb dramatically above the latter values in the lower density states. Because Verizon's service area in Virginia has a lower density of population (and thus lines) than Verizon's service area in New York, the problem squarely arises here as well.

There are, in theory, three possible remedies for this problem. One is to identify and solve the apparent defect in the transport cost module of the Synthesis Module. As all parties agree, however, that remedy is beyond the scope of this proceeding.

The second alternative is to consider a switching-only benchmark analysis as well an aggregate non-loop analysis (which would eliminate the taint of the inflated transport cost estimates on the benchmarking analysis for switching). As shown in Exhibit 1 hereto, a switching-only benchmark analysis demonstrates that Verizon's newly reduced switching prices still exceed Verizon's switching prices in New York, on a cost adjusted basis, by a substantial margin.[15]

The third alternative is to consider the evidence submitted by the parties on the *ultimate* pricing issue: whether the non-transport non-loop rates (of which switching is the most important) were set in compliance with TELRIC. AT&T has submitted evidence pursuant to this alternative as well. As summarized in Section I, *supra*, this

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UNE prices set by state commission are themselves TELRIC compliant; to the contrary, a number of those prices exceed TELRIC levels as well. Nevertheless, those prices are the best available indicator of state-specific transport costs for an analysis of this kind, and they provide a clear qualitative demonstration of the inverse relationship between line density and the overstatement of transport costs by the Synthesis Model.

[15] Significantly, even other incumbent local exchange carriers have begun to recognize the usefulness of a separate switching-only benchmark. *See* WC Docket No. 02-314, *Qwest Communications International Inc. Application for Authority to Provide In-Region InterLATA Services in Colorado, etc.*, Ex Parte letter dated Oct. 7, 2002, from David L. Sieradzaki (Qwest) (submitting switching-only benchmarking analysis of Qwest rates in Idaho, Iowa, Montana, Nebraska, North Dakota, Utah, and Wyoming).

evidence demonstrates that Verizon's switching prices still exceed just and reasonable levels.

Verizon's position is that, because alternative 1 is infeasible, the Commission should ignore alternatives 2 and 3 as well. AT&T respectfully submits that this position is both illogical and legally indefensible, and the Commission's analysis of the issue in its *New Hampshire/Delaware 271 Decision* failed to come to grips with the reasons why.

First, the notion that AT&T and other CLECs have no standing to raise the issue because they do not currently buy unbundled switching separately from unbundled transport and other non-loop elements (*id*. ¶¶ 53-54) ignores the reality that the density-related overstatement of transport costs by the Synthesis Model overstates the *aggregate* costs of non-loop elements in the lower density states, and therefore understates their *aggregate* rate-to-cost ratios. The flaw in the transport module of the Synthesis Model—a tendency to overstate transport costs, and to overstate them more in states with lower population density—exaggerates relative costs in lower density states, and under-states their cost-adjusted rates, for the non-loop elements in the aggregate, *not just switching alone*. A benchmark analysis of aggregate nonloop costs that relies on Synthesis Model data on the cost differences vis-à-vis New York allows Verizon to inflate the cost of competitive entry in states with lower population densities *even for CLECs that never buy switching separately from the other nonloop elements*. CLECs thus are aggrieved by this error regardless of whether they ever buy any unbundled switching separately from other non-loop elements.[16]

Second, the existence of the "extensive record" developed in the rulemaking proceeding leading to the adoption of the Synthesis Model (*id*. ¶ 47) provides no

[16] *See* New Hampshire/Delaware 271 proceeding (WC Docket No. 02-157), AT&T Sept. 20, 2002 ex parte filing.

justification for relying on the model in particular circumstances where it is demonstrably ill-suited. As AT&T has noted in the New Hampshire/Delaware proceeding, the purpose of the rulemaking proceeding that led to adoption of the Synthesis Model was for universal service subsidy calculations, in which relative differences in transport costs play a relatively small part.[17] The Commission's decision in the New Hampshire/Delaware 271 cases overlooked this fact.

Nor can inflexible reliance on an aggregate non-loop benchmark analysis be justified on the theory that the Synthesis Model is "the best tool we have for evaluating cost differences between states." *New Hampshire/Delaware Decision* ¶ 47. When the Commission has the alternatives of (1) using the Synthesis Model to perform a comparison of the *switching*-only costs, and (2) considering the record evidence that bears directly on whether Verizon's switching rates in Virginia are TELRIC-compliant, mechanical application of the Synthesis Model to compare all non-loop costs in the aggregate is clearly *not* the best available tool in the particular circumstances here.

Equally illogical is the proposition that an aggregate non-loop benchmark analysis must serve as an unrebuttable rule of decision in all cases because, "in the context of universal service, AT&T has supported the Synthesis Model before the Commission and before the appellate courts," *id*. AT&T has clearly expressed concerns that the Model provides a conservative -- indeed, overstated -- measure of the costs of transport.[18] Likewise, while the Commission has found that the Synthesis Model "accurately reflects

[17] *See* New Hampshire/Delaware 271 proceeding, AT&T Reply Comments (Aug. 12, 2002) at 8; *id*., Lieberman/Pitkin Reply Decl. ¶¶ 16-17.

[18] *Id*., Lieberman/Pitkin Reply Decl. ¶¶ 16-17.

the relative cost differences among states," the Commission has never found that it produces accurate cost estimates for the pricing of transport UNEs.[19]

It is Verizon, not AT&T, that is guilty of inconsistency on this issue. Just a few months ago, in the Virginia UNE arbitration that remains pending before the Commission, Verizon assailed the Synthesis Model (including its transport module) as "incapable of estimating company- and state-specific UNE rates with any accuracy."[20] The Model, Verizon added, "is not designed to model, nor can it be modified to account for, the costs of the full and robust network that is the focus of UNE proceedings."[21] The "underlying platform" of the Model "prevents it from accurately measuring the forward-looking costs that Verizon VA or, for that matter, any efficient carrier, would incur in providing the full range of UNEs required by the Commission."[22] Verizon has never retracted these criticisms. Indeed, in the Virginia UNE arbitration, Verizon supports estimates of transport costs that are only *one third* as high as the estimates obtained by AT&T from the Synthesis Model.[23]

The proposition that considering switching-only benchmark comparisons, or looking directly at the TELRIC-compliance of Verizon's switching costs, would "compromise the ability of the Commission to rely on the Synthesis Model in other contexts" (New Hampshire/Delaware 271 decision ¶¶ 48-49) is another non sequitur.

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[19] *See id*., Lieberman/Pitkin Reply Decl. ¶ 21; *Federal-State Joint Board on Universal Service*, Fifth Report and Order, 13 FCC Recd 21323 (1998) ("Platform Order"), ¶ 75.

[20] *Petitions of WorldCom, Inc., Cox Virginia Telecom, Inc., & AT&T Communications*, CC Docket Nos. 00-218 and 00-251, Verizon Reply Post-Trial Brief on Cost Issues (Jan. 31, 2002) at 133.

[21] *Id*.

[22] *Id*. at 134.

[23] New Hampshire/Delaware 271 proceeding, AT&T Reply Comments (Aug. 12, 2002), Lieberman/Pitkin Reply Decl. ¶¶ 18-19.

Considering the alternative evidence submitted by AT&T does not require the Commission to abandon use of the Synthesis Model to benchmark non-loop costs generally, let alone to jettison the model for other regulatory contexts. Whether to take those drastic steps are issues that can (and should) be deferred to other proceedings.[24] To justify considering the additional evidence that AT&T has submitted here, the Commission need find only that (1) an issue has been raised about accuracy of the Synthesis Model transport costs estimates, and (2) rather than resolve the issue now, the Commission will consider the supplemental evidence tendered by AT&T.[25]

The proposition that automatic application of benchmarking is permitted by the deferential standard of review of state commission cost findings under the Act (New Hampshire/Delaware Decision ¶¶ 50-52) is also unfounded. The degree of deference to give in reviewing cost findings by state commissions is an entirely separate issue from the degree of disaggregation by which the review, deferential or otherwise, must focus. And the fact that the Commission's benchmarking presumptions are a reasonable administrative shortcut in many circumstances does not provide a justification for applying those presumptions in the minority of circumstances where the presumptions are dysfunctional.

The Commission's failure to provide a reasoned response to these points in the New Hampshire/Delaware proceeding precludes reliance on the final decision in that case as a rule of decision for this one. "An agency rule would be arbitrary and capricious if

[24] In the context of the Universal Service Fund, for example, it is relevant that only a small fraction of the total monthly USF cost—approximately one to two percent for these states. Hence, the overstatement of transport costs by the Synthesis Model is not a major concern for USF purposes.

[25] In any event, the cat is already out of the bag. As noted above, *existing* state UNE pricing determinations have already resulted in unbundled transport prices that are significantly below Synthesis Model cost estimates—and the disparity is greatest in the states with the lowest line and population densities.

the agency . . . entirely failed to consider an important aspect of the problem." *Motor Vehicles Mfrs. Ass'n v. State Farm Mut. Auto Ins. Co.*, 463 U.S. 29, 43 (1983). *Accord*, *Professional Pilots Fed. v. FAS*, 118 F.3d 758, 771 (D.C. Cir. 1997) (same). The Commission's failure to "open its mind" to "relevant consideration[s]" is clear error. *Association of American Publishers v. Governors of the USPS*, 485 F.2d 768, 774 (D.C. Cir. 1973).

CONCLUSION

For the foregoing reasons, and those stated in AT&T's previous comments, Verizon's application for authorization to provide in-region, interLATA services in Virginia should be denied.

Respectfully submitted,

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October 9, 2002

CERTIFICATE OF SERVICE

The undersigned hereby certifies that a copy of the foregoing Reply Comments of AT&T Corp. was served, by the noted methods, the ninth day of October, 2002, on the following:

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